No. 12206.

IN THE

United States Court of Appeals

FOR THE NINTH CIRCUIT

GEORGE T. GOGGIN, Receiver of the Estate of SALSBURY MOTORS, INC., Debtor,

Appellant,

vs.

BANK OF AMERICA NATIONAL TRUST AND SAVINGS ASSOCIATION,

Appellee.

APPELLANT'S OPENING BRIEF.

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I.

JURISDICTIONAL STATEMENTS.

1. The District Court Had Jurisdiction of This Cause.

As a court of bankruptcy, the United States District Court had jurisdiction of this cause pursuant to the Act of July 1, 1898, as amended. (Chapter 541, Sections 1 and 2, 30 Stat. 544, 545, as amended; United States Code, Title XI, Chapter 1, Section 1, and Chapter 2, Section 11.) On August 20, 1947, the debtor (hereinafter referred to as "Salsbury") filed a petition under Chapter XI of the Bankruptcy Act in this proceeding. [Tr. 2-7.] On the same day the petition was approved by the Honorable Leon R. Yankwich, Judge of the United States District Court, and the matter was referred to Hugh L. Dickson,

Esq., one of the Referees of said Court. [Tr. 7-8.] On November 20, 1947, the appellant Receiver filed a PETITION FOR ORDER TO SHOW CAUSE RE: JACQUES POWER SAW CO. [Tr. 37-30.] On September 9, 1947, appellee, Bank of America National Trust and Savings Association (hereinafter referred to as "Bank" or "Bank of America"), filed a proof of partially secured debt. [Tr. 13-36.] On December 2, 1947, the Bank filed written objections to the jurisdiction of the Referee to entertain said petition. [Tr. 40-43.] On December 22, 1947, appellant Receiver filed OBJECTIONS TO CLAIM OF THE BANK OF AMERICA NATIONAL TRUST AND SAVINGS ASSOCIATION, AND PRAYER FOR AFFIRMATIVE RELIEF. [Tr. 48-57.] On January 12, 1948, the Referee below overruled the Bank's objections to the jurisdiction of said Referee to determine the PETITION FOR ORDER TO SHOW CAUSE RE: JACQUES POWER SAW CO. [Tr. 67], and pursuant to stipulation of counsel for Receiver and the Bank an order was signed and filed consolidating said PETITION FOR ORDER TO SHOW CAUSE RE: JACQUES POWER SAW CO. and said OBJECTIONS TO CLAIM OF THE BANK OF AMERICA NATIONAL TRUST AND SAVINGS ASSOCIATION, AND PRAYER FOR AFFIRMATIVE RELIEF, for all purposes of hearing and decision. [Tr. 67-68.] Said stipulation for consolidation also contained a stipulation of facts for all purposes of hearing and decision of said consolidated proceedings, and said stipulation was filed on January 12, 1948. [Tr. 68-77.] On or about March 22, 1948, the Referee below filed Findings of Fact, Conclusions of Law and an Order Allowing the Claim of appellee Bank. [Tr. 80-92.] The Referee [Tr. 10], states that this was signed and filed on March 22, 1948, but the Transcript on page 92 indicates that it was filed on March 16, 1948. A petition to re-

view said order allowing claim was duly filed by Receiver appellant. [Tr. 93-99.] On January 19, 1949, the United States District Court, through the Honorable C. E. Beaumont, filed an ORDER DENYING PETITION FOR REVIEW IN RE BANK OF AMERICA—BANKERS' LIEN LITIGATION. [Tr. 109-110.]

2. The Court of Appeals Has Jurisdiction of This Appeal.

Within the time allowed by law, your appellant filed a notice of appeal [Tr. 111] and has taken the steps required by law presenting the necessary record on the within appeal.

The jurisdiction of the Court of Appeals is invoked pursuant to Sections 24 and 25 of the Bankruptcy Act (Act of July 1, 1898, as amended, Chapter 541, Sections 24 and 25; 30 Stat. 533, as amended; United States Code, Title XI, Chapter 4, Sections 47 and 48). Appellate jurisdiction over this proceeding in bankruptcy vested in the Court of Appeals upon the filing on February 2, 1949, of the notice of appeal, the amount involved being in excess of $500.00, and the appeal being taken by the Receiver.

II.

STATEMENT OF THE CASE.

This appeal is from an order of the District Court entitled, "ORDER DENYING PETITION FOR REVIEW IN RE BANK OF AMERICA—BANKER'S LIEN LITIGATION," dated and entered on January 19, 1949. [Tr. 109-110.] That order in turn approves the order of the Referee in Bankruptcy dated March 22, 1948. [Tr. 91-92.]

The facts in this case are largely to be found in a stipulation by and between the appellant and the Bank, through

their respective counsel, which stipulation was before the Referee and the District Court below. [Tr. 68-77.] According to that stipulation, the claimant Bank loaned Salsbury, debtor herein, the sum of $180,000.00, which loan was secured by a deed of trust on certain real property; the plant of Salsbury was located on that property. The deed of trust by its very terms was to secure the repayment of the $180,000.00 and any other indebtedness of Salsbury to the Bank, whether then existing or thereafter created. At the same time the Bank entered into an agreement with Salsbury by the terms of which the Bank agreed to extend credit to Salsbury in the aggregate sum of $500,000.00, to be repayable in annual installments on or before September 30, 1950. Subsequently (September 3, 1946) this agreement was amended so that the Bank agreed to increase the credit by an additional revolving credit not to exceed $450,000.00, until September 30, 1947. [Tr. 69.]

Pursuant to this credit agreement, the Bank loaned Salsbury, an aggregate amount in excess of $600,000.00. From the time of the agreement, the Salsbury regularly maintained its major deposit accounts with the Bank as a bank of deposit. During this same period, Salsbury also deposited with the Bank, for collection only, notes and drafts accompanied by order bills of lading evidencing sales of merchandise by Salsbury. In the regular course of business these notes and drafts were collected and the proceeds credited to the Salsbury's commercial account. From June of 1946 until December of 1946, these collection items deposited with the Bank averaged from $40,000 to $50,000 per month, and during the year 1947 up to August 20, 1947 (the date of the filing of the petition herein), these collection items so deposited with the Bank

averaged approximately $150,000.00 per month. [Tr. 70.]

On August 19, 1947 (Salsbury informed the Bank on the day before the filing of the petition herein), Salsbury was in default in the payment of its indebtedness to the Bank, and on that day the Bank offset the balance of various deposit accounts of Salsbury in the aggregate amount of $161,125.55 and refused to allow withdrawals. Taking into account this offset, there was due and unpaid on account of the indebtedness of the Salsbury to the Bank, the principal sum of $601,482.80. [Tr. 70.]

On the date of the filing of the petition herein, August 20, 1947, the Bank held in its custody certain notes and drafts drawn upon drawee purchasers in amounts set forth in the Transcript herein at pages 54 and 55 [Exhibit A to appellant's OBJECTIONS TO CLAIM OF THE BANK OF AMERICA etc.], totaling $178,950.93. The Bank of America likewise held order bills of lading representing the right to receive merchandise described therein, which merchandise was in the course of shipment to the various drawee purchasers. [Tr. 71.]

Subsequent to August 20, 1947, the Bank collected substantially all of the totals represented by said bills of lading except for certain rejected drafts, more fully described in the stipulation. [Paragraph IV, Tr. 71-74.]

Among the collection items in the possession of the Bank at the time of the filing of the petition herein was a promissory note executed by the Jacques Power Saw Co. of Denison, Texas, payable to the debtor in the principal amount of $35,837.00 on July 16, 1947. That note was deposited with the Bank by Salsbury on or about July 8, 1947, pursuant to the usual agreement for collection,

only, and was transmitted to the correspondent of the Bank of America in Denison, Texas. Payment of this note was refused and the note was returned to Bank of America on or about July 31, 1947. On or about August 1, 1947, the Bank informed Salsbury that this note had been returned, and Salsbury instructed the Bank to resubmit the note for collection. There had been certain undelivered items mistakenly included in the amount of the note and Salsbury had issued on its books a credit memorandum of $1,163.50 to the Jacques Power Saw Co. On August 21, 1947, Salsbury delivered to the Bank the following letter:

"August 21, 1947.

Bank of America National
Trust and Savings Association
Pomona, California.

Attn: Mr. Farrand

Gentlemen:

On July 8, 1947, we deposited with you for collection a promissory note on which Jacques Power Saw Company of Denison, Texas, was the payor and Salsbury Motors, Inc., was the payee. The note was due July 16, 1947, and was in the principal amount of $35,837.00.

Please be advised that your authority to collect said note is hereby terminated, effective immediately. Collection will be effected by direct dealings between ourselves and Jacques Power Saw Company.

Very truly yours,
SALSBURY MOTORS, INC.
/s/ G. R. CASE,
General Manager."

[Tr. 74-75.]

On or about August 22, 1947, Salsbury agreed with the maker of the note that the credit memorandum of $1,-163.50 was a proper credit on the note. The Bank, however, failed to recognize the termination of authority and on or about August 25, 1947, the maker of the note paid the net amount of $34,653.50 to Bank of America's correspondent bank in Denison, Texas, upon surrender of the note. These funds were received by Bank of America on or about August 27, 1947. [Tr. 75-76.]

In addition to the foregoing facts, the parties hereto had also stipulated to the following [Tr. 76]:

"VI.

None of the notes and drafts or bills of lading accompanying the same deposited by the debtor with claimant as collection items during the course of the operation of the business of the debtor from the time of the loan agreement on February 18, 1946, to the date of filing the petition in the above-entitled proceedings was at any time pledged by the debtor to secure any indebtedness of the debtor to claimant. No immediate credit was given by claimant to the deposit accounts of the debtor upon the deposit of any of said collection items but all of said items were deposited with claimant for collection and credit of the proceeds of the collection to the deposit account of the debtor when said collections were completed. During the period from February 18, 1946, to August 19, 1947, claimant did, in the usual course of business, credit to the deposit account of the debtor, as and when received, the proceeds of all collection items in accordance with the instructions of the debtor. In each of the collection items in the hands of claimant on August 20, 1947, the debtor had issued and claimant had accepted instructions to credit the proceeds of said collections when received to the commercial deposit account of the debtor."

The Bank refused to turn over to Salsbury any of the notes, drafts or collection items hereinbefore referred to, or the proceeds thereof, and on or about September 9, 1947, the Bank duly filed its proof of claim against the estate of Salsbury in the principal sum of $601,482.80, together with interest thereon as set forth in said claim. [Tr. 77; 13-36.] On November 20, 1947, Salsbury filed a PETITION FOR ORDER TO SHOW CAUSE AGAINST BANK OF AMERICA RE: JACQUES POWER SAW CO. in the Bankruptcy Court, stating the facts with respect to said note, already set forth herein, and requesting an order directing the Bank to show cause why the Bankruptcy Court should not make an order forthwith directing Bank of America to pay the sum of $34,673.50 to the Receiver. [Tr. 37-39.] An order to show cause was issued thereon on the same day [Tr. 39-40] and on December 2, 1947, the Bank filed its objections to the summary judgment of the Bankruptcy Court. [Tr. 40-43.] The Referee below filed a memorandum opinion on December 8, 1947, indicating that the Bank's objections to the summary jurisdiction were overruled, holding that the Bank had only a colorable claim, and was not a bona fide adverse claimant. [Tr. 44-47.]

On December 22, 1947, the appellant Receiver also filed OBJECTIONS TO CLAIM OF THE BANK OF AMERICA NATIONAL TRUST AND SAVINGS ASSOCIATION AND PRAYER FOR AFFIRMATIVE RELIEF, in which the Receiver contended that Salsbury was the owner of the negotiable paper in the custody of the Bank at the time of the filing of the petitions, and that Salsbury was further entitled to the

physical, as well as legal, possession of this paper. At the same time, the Receiver prayed for an order sustaining his objections to the claims of the Bank, and for an affirmative order directing the Bank to forthwith turn over to the Receiver the sum of $178,950.93. [Tr. 48-57.] The Bank filed an answer to the objections of the Receiver on January 12, 1948. [Tr. 58-66.] On the same day the Referee overruled the Bank's objections to the summary jurisdiction of the Bankruptcy Court and ordered that the PETITION FOR ORDER TO SHOW CAUSE AGAINST BANK OF AMERICA RE: JACQUES POWER SAW Co. be consolidated by stipulation [Tr. 68-69], with the above described OBJECTIONS TO CLAIM OF THE BANK OF AMERICA NATIONAL TRUST AND SAVINGS ASSOCIATION AND PRAYER FOR AFFIRMATIVE RELIEF for all purposes of hearing and decision. [Tr. 67-68.] The stipulation of facts [Tr. 68-77] referred to in this brief was also filed on January 12, 1948.

On March 4, 1948, the Referee filed a memorandum opinion with respect to the claim of the Bank of America, in which he stated that under Section 3054 of the Civil Code of California, the Bank was entitled to a lien upon the negotiable paper placed in the custody of the Bank by Salsbury for the purposes of collection, and that the Bank was therefore entitled to retain the money which it collected upon that commercial paper. [Tr. 78-80.] FINDINGS OF FACT, CONCLUSIONS OF LAW, AND ORDER ALLOWING THE CLAIM were thereupon filed on March 22, 1948 [Tr. 80-92.]

A petition for a review was duly filed in the District Court [Tr. 93-99], and said District Court, through the Honorable C. E. Beaumont, denied the petition for review by an order dated January 19, 1949. [Tr. 109-110.] Notice of Appeal from that order was filed by your appellant [Tr. 111] and all other steps were taken to perfect the appeal. [Tr. 111-117.] The ORDER DENYING PETITION FOR REVIEW IN RE BANK OF AMERICA—BANKER'S LIEN LITIGATON [Tr. 109-110] from which this appeal was taken "confirms, approves and adopts the Findings of Fact and Conclusions of Law" of the Referee below. [Tr. 110.] A reading of the Referee's MEMORANDUM OPINION ON CLAIM OF BANK OF AMERICA [Tr. 78-80] and his FINDINGS OF FACT, CONCLUSIONS OF LAW AND ORDER ALLOWING CLAIM [Tr. 80-92] reveals that the rulings and orders below are based upon the applicability of the so-called banker's lien to the facts of the present case.

The appellant receiver contends, in summary, that the Bank had only mere limited custody rights as to the notes and drafts. The Bank was an agent and possession and ownership remained in Salsbury until collection was effected and the proceeds deposited in Salsbury's regular commercial account. The notes and drafts in question had not been collected in any amount when the petition herein was filed and no credit had been extended thereon by the Bank. The Bank converted the notes and drafts to its own use and is therefore indebted to this estate in the amount of the face value of the notes, *i. e.*, $178,950.93.

III.

SPECIFICATION OF ERRORS.

The Order Denying Petition for Review In re Bank of America—Banker's Lien Litigation [Tr. pp. 109-110] Is Erroneous in That:

1. THERE WERE NO FACTS BEFORE THE REFEREE OR THE DISTRICT JUDGE TO JUSTIFY THE RETENTION BY THE BANK OF SALSBURY'S NOTES AND DRAFTS OR THE PROCEEDS THEREOF UPON ANY THEORY OF SET-OFF AND THE RETENTION WAS PARTICULARLY UNJUSTIFIED UNDER SECTION 68(a) OF THE BANKRUPTCY ACT.

2. THERE WERE NO FACTS BEFORE THE REFEREE OR THE DISTRICT JUDGE WHICH WOULD JUSTIFY THE RETENTION BY THE BANK OF SALSBURY'S NOTES AND DRAFTS OR PROCEEDS THEREOF, UPON THE THEORY OF A BANKER'S LIEN.

IV.

SUMMARY OF ARGUMENT.

A. THE BANK WAS NOT ENTITLED TO RETAIN THE NOTES AND DRAFTS UNDER ANY THEORY OF SET-OFF AND PARTICULARLY COULD NOT JUSTIFY ITS POSITION UNDER SECTION 68(a) OF THE BANKRUPTCY ACT.

1. THE RIGHTS OF CREDITORS ARE FROZEN AS OF THE DATE OF THE FILING OF THE PETITION FOR ARRANGEMENT AND THE RELATIONSHIP OF THE BANK TO THE APPELLANT MUST BE DETERMINED AS OF THAT DATE. AS OF THE DATE OF THE FILING OF THE PETITION HEREIN (AUGUST 20, 1947), THE BANK AND SALSBURY OCCUPIED THE RELATIONSHIP OF AGENT AND PRINCIPAL, RESPECTIVELY, AS TO THE NOTES AND DRAFTS BELONGING TO SALSBURY AND HELD BY THE BANK FOR COLLECTION ONLY.

B. THE APPELLEE CANNOT JUSTIFY ITS SEIZURE OF THE NOTES AND DRAFTS UNDER THE BANKER'S LIEN SET FORTH IN SECTION 3054 OF THE CIVIL CODE OF CALIFORNIA.

1. SECTION 3054 OF THE CALIFORNIA CIVIL CODE MERELY RESTATES THE LAW MERCHANT WHICH IMPOSED THE REQUIREMENT THAT A BANK EXTEND CREDIT UPON THE FAITH OF COMMERCIAL PAPER AS A CONDITION PRECEDENT TO ACQUISITION BY THE BANK OF A LIEN UPON SUCH PAPER.

2. THE CALIFORNIA COURTS AND THE COURTS GENERALLY PERMIT A BANK TO EXERCISE A LIEN UPON COMMERCIAL PAPER DEPOSITED WITH THE BANK FOR COLLECTION ONLY WHERE THE BANK HAS EXTENDED CREDIT UPON THE FAITH OF SUCH PAPER.

3. THE PURPORTED APPLICATION HEREIN OF THE BANKER'S LIEN IS CONTRARY TO THE SPIRIT OF THE BANKRUPTCY ACT AND PARTICULARLY OFFENSIVE TO A PROCEEDING UNDER CHAPTER XI.

V.

ARGUMENT.

Introduction.

The instant appeal raises questions of extreme importance to the administration of the bankruptcy laws. Here is a case in which a corporation borrowed large sums of money from a bank, these loans partially secured by a trust deed. Salsbury, the corporation, maintained a deposit account with this bank, appellee Bank of America, and in addition transmitted to the Bank large amounts of commercial paper in the form of notes and drafts accompanied by order bills of lading evidencing sales of merchandise by Salsbury. These notes were to be collected by the Bank and the proceeds of such collections were to be deposited in Salsbury's regular deposit account. Salsbury filed a petition under Chapter XI of the Bankruptcy Act on August 20, 1947. The day before that petition was filed, the Bank off-set the deposit account of Salsbury in the aggregate amount of $161,-125.55. The Bank also retained its security in the form of a trust deed, as additional security for its loan. After August 19, 1947, Salsbury was unable to draw upon its credit at the Bank. Despite this, the Bank nevertheless asserted a purported lien (or right of set-off, in the alternative) upon the notes and drafts belonging to Salsbury and totaling $178,950.93. This lien or right of set-off, was asserted by the Bank after the filing of the petition in reorganization, after the demand by Salsbury for the return of the notes, after the cessation of general

credit by the appellee Bank, and at a time when the Bank had extended no credit in reliance upon the notes.

Salsbury, seeking rehabilitation, found itself in a most unenviable position. The Bank, owing to Salsbury's default, claimed a right to Salsbury's real property under the deed of trust which secured the indebtedness; the Bank had wiped out Salsbury's cash position by setting off the bank deposit; it had appropriated the only other ready source of funds available to Salsbury by the assertion of the purported banker's lien or right of set-off upon Salsbury's notes and drafts transmitted to the bank for collection.

In these consolidated proceedings, the appellant receiver has attacked the conversion by the Bank of the debtor's negotiable paper. The Bank first resisted on the ground of lack of summary jurisdiction, but that point will not be discussed herein because the Referee below ruled in favor of the jurisdiction of the Bankruptcy Court, adversely to the Bank and the Bank does not seek review. It is further notable that the Referee below, and the District Judge, likewise, presumably rejected one of the Bank's arguments on the merits, that is, the alleged right of the Bank to "set off" the notes and drafts in its possession against the debt of Salsbury. [Tr. 88-90.] As a matter of fact, the Bank seems to have abandoned this contention as untenable. The Bank's other argument on the merits was accepted by the Courts below; namely, that under Section 3054 of the California Civil Code, the Bank was entitled to exercise a so-called banker's lien

upon the notes and drafts in its custody for collection only, but which, notes and drafts belonged to the debtor.

Appellant will address himself in this brief to both of the Bank's arguments on the merits; however, special emphasis will be placed upon arguments pertaining to the banker's lien. In that regard, appellant stresses that the Bank extended no credit upon the faith of the Salsbury's notes and drafts in the custody of the Bank for purposes of collection. Thus, no lien extended to the Bank either under the general commercial law or under the California Civil Code, Section 3054, which is a codification of that law. More than that, such a lien would be a rejection of the equitable principles governing bankruptcy proceedings including proceedings under Chapter XI of the Bankruptcy Act.

A. The Bank Was Not Entitled to Retain the Notes and Drafts Under Any Theory of Set-Off and Particularly Could Not Justify Its Position Under Section 68(a) of the Bankruptcy Act.

(1) The Rights of Creditors Are Frozen as of the Date of the Filing of the Reorganization Petition and the Relationship of the Bank to the Appellant Must Be Determined as of That Date. As of the Date of the Filing of the Petition Herein (August 20, 1947), the Bank and Salsbury Occupied the Relationship of Agent and Principal, Respectively, as to the Notes and Drafts Belonging to Salsbury and Held by the Bank for Collection, Only.

With respect to the notes and drafts involved herein, the respective rights of the parties must be determined as of the date of the filing of the reorganization petition, that is, August 20, 1947.

"The general rule in bankruptcy is that the filing of the petition freezes the right of all parties interested in the bankrupt estate."[1]

Section 68(a) of the Bankruptcy Act provides as follows:

"In all cases of mutual debts or mutual credits between the estate of a bankrupt and a creditor, the account shall be stated and one debt shall be set off against the other, and the balance only shall be allowed or paid."

The rights of the parties under Section 68 are subject to the foregoing rules and are adjusted as of the date of bankruptcy; in the case of a petition filed under Chapter XI, the date of cleavage is the date of the filing of the petition for arrangement.[2]

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[1]4 Collier on Bankruptcy (14th Ed.), 228.

See, also, *Goggin v. Division of Labor Law Enforcement, State of California* (1948), 336 U. S. 118, at pp. 125-126:

"This general point of view in interpreting the Bankruptcy Act is one of long standing. In *Everett v. Judson,* 228 U. S. 474, 479, this Court said:

'We think that the purpose of the law was to fix the line of cleavage with reference to the condition of the bankrupt estate as of the time at which the petition was filed and that the property which vests in the trustee at the time of adjudication is that which the bankrupt owned at the time of the filing of the petition.'

"See also, *Myers v. Matley,* 318 U. S. 622, 626; *United States v. Marxen,* 307 U. S. 200, 207-208; *Acme Harvester Co. v. Beekman Lumber Co.,* 222 U. S. 300, 307."

In *United States v. Marxen* (1939), 307 U. S. 200, at 207-208, the Court stated:

". . . the rights of creditors are fixed by the Bankruptcy Act as of the filing of the petition in bankruptcy. . . . The transfer of the assets to someone for application to 'the debts of the insolvent, as the rights and priorities of creditors may be made to appear,' takes place as of that time."

[2]*Lockhart v. Garden City Bank & Trust Co.* (C. C. A. 2d, 1940), 116 F. 2d 658; see also 4 Collier on Bankruptcy (14th Ed.), 743.

As of the date of cleavage, August 20, 1947, the relationship between Salsbury and the Bank herein was that of principal and agent. It is well established that when notes are placed in the hands of a bank for collection, and the bank does not advance credit on the notes, the bank takes the notes as an agent only and the owner is the principal of the bank with respect to those notes.[3] The California courts recognize this accepted principle of law. For example, in *National Bank of New Zealand v. Finn* (1927), 81 Cal. App. 317, at 336, the Court states in its opinion:

> ". . . The law seems to be well-settled that if a check for bill of exchange is taken for collection only by a bank, the bank does not take title, but acts merely as a collection agent and that the property in the check or draft remains in the depositary (*sic*) and that the relation arising from the transaction is not that of debtor and creditor but that of principal and agent."

Thus, at the time of cleavage, the Bank of America held certain property in the form of notes and drafts belonging to Salsbury, the Bank's principal. In addition, shortly thereafter and before collection of the notes and drafts, the principal ordered the agent to return the property; this the agent refused to do in violation of its agency and proceeded in an unauthorized manner to convert the notes and drafts to its own use and to collect the amounts represented by those notes and drafts. Under California law, the Bank could acquire no property in the notes and drafts until they had been reduced to the form of a deposit

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[3]6 Michie (1931), Banks & Banking, at p. 19, and cases there cited.

in the name of the debtor.[4] By that time the petition herein was filed and the authority of the agent had been countermanded.

Accordingly, no mutual debts existed for set-off purposes with respect to the notes and drafts.[5]

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[4]*Powell v. Bank of America* (1942), 53 Cal. App. 2d 458, at p. 464.

[5]Since the notes and drafts were held by the Bank as agent at the date of cleavage, there could be no mutual debts or mutual credits within the meaning of Section 68(a) of the Bankruptcy Act. The notes and drafts were obligations owing by third parties to Salsbury; the Bank had custody of these instruments and proceeded deliberately in an attempt to convert that mere custody to an ownership under the guise of a purported deposit of the subsequent collection.

The Bank could claim the right to set-off on only two conceivable grounds: either that the moneys collected on the notes and drafts are to be considered deposits and therefore subject to set-off against the debt owing to the Bank or that the notes and drafts themselves constituted a proper subject of set-off. The first theory is clearly untenable since deposits made after the filing of the reorganization petition cannot be subjected to any purported right of set-off.[4 Collier on Bankruptcy (14th Ed.), 772-775. See also discussion in *In re Susquehanna Chemical Corporation* (1949, D. C., Pa.), 81 Fed. Supp. 1, at pp. 8-9, affirmed in *Susquehanna Chemical Corp. v. Producers Bank & Trust Co.* (April 27, 1949, C. A. 3), C. C. H. Bankruptcy Law Service, par. 56,415.]

The contention that the Bank could set-off the notes and drafts themselves is equally unsound. These notes and drafts were not owing by the Bank to Salsbury. They were evidences of indebtedness, choses in action, negotiable in form, owing by third persons to Salsbury. They were held by the Bank as mere agent for Salsbury and should either have been returned to the latter or if collected, deposited in the name of Salsbury in the form of a deposit subsequent to the filing of the reorganization petition and therefore not subject to any doctrine of set-off. Even *funds* held by the Bank could not be set-off if such funds were held by the Bank as a bailee for the debtor. That point was clearly decided by this Court in *Continental National Bank v. Moore* (1924, C. C. A. 9), 299 Fed. 270, at 272. In that case, the opinion of this Court stated:

> "The money so deposited and the debt due from the bankrupt to the bank were not in the nature of 'mutual credits' and 'debts,' within the meaning of section 68a of the Bankruptcy Act (Comp. St. §9652). The right of set-off attached upon the moneys of a customer deposited with a bank 'in the

B. The Appellee Cannot Justify Its Seizure of the Notes and Drafts Under the Banker's Lien Set Forth in Section 3054 of the Civil Code of California.

The Referee and District Court below relied upon the purported banker's lien, under the laws of the State of

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usual course of business for advances which are supposed to be made upon their credit.' Michie, Banks and Banking, §134. As to the fund which represented the proceeds of the bankrupt's business, the relation between the appellant and the bankrupt was not that of banker and depositor, but that of bailee and bailor. The statute of California (Civil Code, §3054) relied upon by the appellant is but expressive of the law merchant, and does not affect the situation. As to the funds so placed in the control of the bank it is well settled that there was no right of set-off. Libby v. Hopkins, 104 U. S. 303, 26 L. Ed. 769; Alvord v. Ryan, 212 Fed. 83, 128 C. C. A. 539; Lehigh Valley Coal Sales Co. v. Maguire, 251 Fed. 581, 163 C. C. A. 575; First Nat. Bank v. Harper, 254 Fed. 641, 166 C. C. A. 139." [See also *Matter of Autler* (D. C. N. Y., 1938), 23 Fed. Supp. 756.]

The rules applicable to bailees, so far as set-off is concerned, are equally applicable to an agent holding a note for collection. The law in this regard has been summarized in 7 Zollman (1936), *Law of Banks and Banking,* at pp. 21-22, in the following language:

> "It is clear, indeed, that the mere possession of notes by a bank without ownership will not constitute them a mutual credit . . .
>
> "Nor will the fact that notes have been received for collection, or the payment of creditors, or are owned by the president of the bank, having been assigned to him by the predecessor bank, or have been executed by the testator while the deposit is by his executor, change the situation." (See also *Federal Reserve Bank of Richmond v. Early* (C. C. A. 4, 1929), 30 F. 2d 198, at 202.

The very wording of Section 68(a) requires that the debts and credits be "mutual" in order for set-off to apply. It is, of course, not always a simple matter to reconcile the vast number of cases dealing with the principle of set-off, particularly where there is a variance from the basic situation of a creditor bank holding a general deposit in the name of the bankrupt.

(See discussion in 7 Zollman (1936), *Law of Banks and Banking,* at pp. 12, 17-18, 19.)

The appellee Bank, in the instant case, for example, placed considerable reliance in the courts below upon the case of *Half Moon Fruit & Produce Co. v. Floyd* (C. C. A. 9, 1932), 60 F. 2d 799,

California, as the ground for permitting the Bank to retain the notes and drafts belonging to Salsbury. Sec-

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where a produce company advanced moneys to a grower upon the express agreement that the grower would turn over his products to the produce company and that the produce company would sell the products and repay those advances out of the first moneys received by it. Pursuant to this agreement the grower sent melons to the produce company and the latter sold the melons and retained the proceeds. The sale of the melons by the produce company was completed by November 11, 1929, and the petition in bankruptcy of the grower was filed on November 25, 1929. This Court held that no preference occurred and that the produce company was entitled to retain the proceeds from the sale of the melons. The appellee Bank, in the instant case, contends that certain dicta in the *Half Moon* supports its position regarding set-off, but it is clear that the produce company extended credit upon the melons (a fact of considerable importance in the later banker's lien section of this brief) and the transaction was wholly completed before the filing of the petition in bankruptcy.

Where there is clearly no mutuality, that is, where the party seeking to apply a set-off has no mutual debt or credit to apply to the debt owing to him by the opposite party, but has property in his custody which he holds in a fiduciary capacity (*e.g.,* as an agent), there is no basis for set-off either under the language of the Bankruptcy Act or under the very reasoning which gave rise to that doctrine. This was precisely the point, as we understand it, in the above quoted *Continental National Bank* case. (This lack of mutuality was further discussed in a more recent case, *United States v. Roth* (C. C. A. 2, 1948), 164 F. 2d 575, at p. 578.)

If the Bank is to assert any right at all to the notes and drafts in its custody as an agent, which notes and drafts belonged to Salsbury, it must base its claim upon some theory of lien. The Bank is, upon analysis, asserting a right as against the notes and drafts themselves; a right which would empower the Bank of America to seize those instruments, collect the amounts owing upon them, and then apply those amounts to the satisfaction of its claim against the debtor. (*Matter of Autler* [D. C. N. Y., 1938], 23 Fed. Supp. 756.) Once the Bank closed the deposit account of Salsbury (as it did on August 19, 1947 [Tr. 70]), no further deposits could have been subject to set-off; any deposit after the Bank forbade payment of checks would have been a payment and a preference. (*Mechanics' and Metals Nat'l Bank of the City of New York v. Ernst* (1913), 231 U. S. 60; *Bank of Commerce and Trusts v. Hatcher* (C. C. A. 4th, 1931), 50 F. 2d 719.)

See, also, *Bank of Calif. v. Brainard* (C. C. A. 9, 1925), 3 F. 2d 3, 5; *Union Bank & Trust Co. v. Loble* (C. C. A. 9, 1927), 20 F. 2d 124; *First Nat. Bk. of Kansas City v. Seldomridge* (C. C. A. 8, 1921), 271 Fed. 561; *Rupp v. Commerce T. & S. Bank* (C. C. A. 6, 1929), 32 F. 2d 234.

tion 3054 of the Civil Code of California provides as follows:

> "§3054. BANKER'S LIEN.—A banker has a general lien, dependent on possession, upon all property in his hands belonging to a customer, for the balance due to him from such customer in the course of the business."

The Referee below expressly stated that he believed that the

> "true answer to the question is to be found in the case of *Gonsalves v. Bank of America,* 16 Cal. (2d) 169 (1940), where at page 173 the Court said:
>
> 'To understand this exercise of the bank's right it is necessary to state briefly its nature. Section 3054 of the Civil Code provides: "A banker has a general lien, dependent on possession, upon all property in his hands belonging to a customer, for the balance due to him from such customer in the course of the business." The banker's lien described in this statute is, properly speaking, a lien on the *securities* such as commercial paper deposited with the bank by the customer in the course of business. The so-called "lien" of the bank on the depositor's *account* or funds on deposit is not technically a lien, for the bank is the owner of the funds and the debtor of the depositor, and the bank cannot have a lien on its own property. The right of the bank to charge the depositor's fund with his matured indebtedness is more correctly termed a right of setoff, based upon general principles of equity. (See Pendleton v. Hell-

man Commercial T. & S. Bank, 58 Cal. App. 448 (208 Pac. 702); 11 Cal. L. Rev. 111, 112; 7 Cal. L. Rev. 341; 38 Harv. L. Rev. 800; Brown on Personal Property, p. 519.)'" [Tr. 78-79.]

It is the purpose of appellant, in the following sections of this brief, to demonstrate that a bank does not have a lien upon securities in its custody where the securities are held for collection only and where no credit was advanced by the bank upon the faith of those securities. The California court, in its above quoted dictum in the *Gonsalves* case, was merely stating the rule pertaining to banker's lien in its most general form. The *Gonsalves* case actually involved the following situation: The defendant bank obtained a deficiency judgment against the plaintiff and filed suit to collect such a deficiency but failed to serve a summons in that action. Several years later the plaintiff was informed by the defendant that a deposit of plaintiff's in defendant's bank was being appropriated under the bank's right of set-off. Plaintiff attempted to withdraw his deposit but the bank refused to honor his check. Plaintiff thereupon brought an action to recover the amount of the deposit; meanwhile, plaintiff caused defendant's earlier action to be dismissed under Sec. 581a of the California Code of Civil Procedure on the ground that the summons had not been served and returned within three years of the filing of the action. In the proceeding brought by Gonsalves, as plaintiff, against the bank, the trial court rendered judgment for the plaintiff upon the ground that since the three year

period under Sec. 581 C. C. P. had run on the bank's original action, no cause of action existed in favor of the bank (defendant) upon which any right of set-off could be exercised. It was this ruling that was reversed by the Supreme Court of California. The plaintiff contended on appeal, in support of the judgment in its favor below, that the bank's set-off was in the nature of a counter-claim and must therefore conform to the procedural requirement for the pleading of a counter-claim by a defendant in a pending action. In reply to this argument of the plaintiff, the Court made the introductory statements relied upon by the Referee herein and went on to state that the right of set-off, although not technically a lien, was nevertheless similar to a lien in its enforcement. That is, the bank could enforce the set-off without the aid of a Court. Therefore, the plaintiff in the *Gonsalves* case was wrong on two counts: first, Sec. 581a is not a statute setting up a statute of limitation, and second, the right of set-off is exercisable without respect to pending actions.

The California court was not purporting to rule upon the requirements of a banker's lien; the Court was merely making a statement introductory to an explanation of the right of set-off. There is no California case holding that a banker's lien may be asserted upon securities held by the bank for collection only, upon which no credit has been extended. Indeed, it will be shown herein that the holdings of the California cases are in opposite direction.

1. **Section 3054 of the California Code Merely Restates the Law Merchant Which Imposed the Requirement That a Bank Extend Credit Upon the Faith of Commercial Paper as a Condition Precedent to Acquisition by the Bank of a Lien Upon Such Paper.**

California Civil Code Section 3054, when enacted, was merely reflective of the already existing law pertaining to banker's liens. This fact should be subject to no dispute, and has been recognized by this Honorable Court as well as by the Courts of the State of California.[6] Section 3054 has never been amended. When it was originally enacted in 1872, the Code Commissioners annotated the section by citing five cases.[7] In order that there may be a unified picture of the state of the law, as conceived by the California Code Commissioners at the time of the enactment of the pertinent code section, it is necessary to separately study the particular cases cited by them.

The banker's lien apparently originated from the practice wherein banks discounted bills of exchange for mer-

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[6]". . . The banker's lien referred to in Section 3054 of the Civil Code, was familiar, as a part of the law, long before the enactment of the Codes. Section 3054 does not extend its scope . . ." *Berry v. Bank of Bakersfield* (1918), 177 Cal. 206, at 209.

". . . This is but a restatement of a well-known rule of commercial law . . ." *Arnold v. San Ramon Valley Bank* (1921), 184 Cal. 632, at 635.

". . . The statute of California (Civil Code, Sec. 3054) relied upon by the appellant is but expressive of the law merchant, and does not affect the situation . . ." *Continental Nat. Bank v. Moore* (C. C. A. 9th, 1924), 299 Fed. 270, at 272.

[7]"NOTE—*Davis v. Bowsher,* 5 T. R., p. 488; see *Brandao v. Burnett,* 3 C. B., p. 519; rev'g S. C., 6 M. & G., p. 630; and affirming S. C., 1 M. & G., p. 908; *Bank of Metropolis v. New England Bank,* 1 How. U. S., p. 234; 6 *Id.,* p. 212; *Van Amee v. Bank of Troy,* 8 Barb., p. 312; 5 How. Pr., p. 161; *McBride v. Farmers' Bank,* 25 Barb., p. 657; 26 N. Y., p. 450." (2 Civil Code of the State of California [1872], p. 315.)

On page vi of the Preface to the foregoing Code, the Code Commissioners explain at length that the object of such "Notes" is to "explain the *reason* and *intent* of the law." (Commissioners' italics.)

chants and thereby extended credit on the bills. Either the banks owned these bills or they were protected by a banker's lien for the advances made on the bills.[8] If, on

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[8]Early English cases so indicate. For example, in *Giles v. Perkins* (1807), 9 East. 11, 103 English Reports 477, the plaintiffs were depositors and the defendants were bankers. The plaintiffs deposited bills of exchange with defendants and the latter went bankrupt at a time when the balance was in favor of the plaintiffs. The bills in dispute were not due when they were deposited. The defendants stated nevertheless, when the plaintiffs sued to recover the bills or their amounts, that banks considered such bills as their own because they had extended credit upon them. The Court held that the plaintiffs could recover the amounts of the bills:

> "Lord Ellenborough, C. J. Every man who pays bills not then due into the hands of his banker places them there, as in the hands of his agent, to obtain payment of them when due. If the banker discount the bill or advance money upon the credit of it, that alters the case; he then acquires the entire property in it, or has a lien on it pro tanto for his advance. The only difference between the practice stated of London and country bankers in this respect is, that the former, if overdrawn, has a lien on the bill deposited with him, though not endorsed; whereas the country banker who always takes the bill endorsed, has not only a lien on it, if his account be overdrawn, but has also his legal remedy upon the bill by the indorsement; but neither of them can have any lien on such bills until their account be overdrawn; and here the balance of the cash account at the time of the bankruptcy was in favour of the plaintiffs." (103 Eng. Rep. at p. 478.)

In a later case, *Thompson v. Giles* (1824), 2 B. & C. 422, 107 English Reports 441, the plaintiff was a silk manufacturer who kept a banking account with the defendants who went bankrupt. When the paper involved in the case was deposited, the bank gave the customer credit to draw upon irrespective of the due date of the bills. The cash balance at the time of the bankruptcy was in favor of the plaintiff. Here, again, the Court was urged to consider the paper as owned by the bank on the basis of custom. Holroyd, J., made the following statement for the Court:

> "I am of opinion that the bills in question did not, under the circumstances of this case, become the property of the bankers, and that the defendants, therefore, have not any sufficient answer to this action. It is perfectly clear, as a general rule, and indeed is not disputed on the present occasion, that if a customer pay bills into a banker's hands, although it gives him a right to expect that his draft will be honoured to the amount of the bills paid in, yet the property in the bills is not altered; they still remain the property of the customer, although the banker may have a lien to the extent of his advances." (107 Eng. Rep. at pp. 444-445.)

the other hand, items were merely placed in the custody of the bank, without any extension of credit thereon, the bank was deemed not to have possession in the legal sense; and the bank could not claim a banker's lien on such items. The lien, therefore, was (and still is) in the nature of an implied pledge.[9]

The English case of *Brandao v. Barnett* has often been cited as a leading authority and was recognized as such

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[9]In *Davis v. Bowsher* (1794), 5 T. R. 488, 101 English Reports 275 (cited by the Code Commissioners, see footnote 7, above), a customer maintained a general account in commercial bills with his banker and received credit thereon. The bank extended credit as desired and discounted such of the bills deposited as most nearly approximated the sum advanced. Some of the bills were not discounted but the bank finally refused further credit and retained all of the bills to protect itself in the event that "any of the discounted bills should prove bad" since some were not yet due. The Court held that the bank was entitled to hold the bills to protect itself since credit had been extended upon the whole account; certain bills had been discounted merely for convenience, not for the purpose of signifying reliance on them alone. Manifestly, the credit was extended on the faith of the entire account and the reporter summed up the Court's holding in the following words:

> "A customer lodges bills of exchange in the hands of his banker generally, and when the banker advances money to him, he applies it to the discount of such bills as happen to be nearest in value to the sum advanced, but without any special agreement to that effect. This does not invalidate the banker's general lien upon all the other bills in his hands, but he may retain them in order to secure the payment of his general balance." (101 Eng. Rep. 275.)

If the *Davis* case is compared to the present case where no credit was extended upon the basis of the notes and drafts in the hands of appellee, the inapplicability of the banker's lien here is effectively highlighted. According to the theory of appellee, the banker's lien is a purely mechanical devise; if property belonging to the debtor is in the hands of the banker, the latter may seize it under the alleged lien without more. As the *Davis* case shows, and as will become more evident from the cases yet to be cited, no such inequitable preference was ever contemplated.

On the other hand, another English case cited by the Commissioners (see footnote 7, above) is *Brandao v. Barnett* (1846), 3 C.

by the California Code Commissioners.[10] In likening the lien to an implied pledge and in asserting that the lien must attach when the bank acquires custody of the items, the English Court illustrates the indispensable nature of the requirement that there be an extension of credit. The lien was held not to arise when certain exchequer bills were placed in the hands of the bank because there had been no credit advanced upon them and no facts analogous to an implied pledge. The *Brandao* case is a flat rejection of appellee's theory that the banker's lien arises upon the mere fact of a debt plus property of the customer in the custody of the bank.

B. 519, 136 English Reports 207, where exchequer bills were placed in the custody of a bank under lock and key. Either the bank or the customer collected the interest, or exchanged the bills in the event that new ones were issued by the government. The bank attempted to assert its lien upon these bills on the ground that the interest on the bills went to the credit of the customer; and upon the further ground that the bank from time to time actually took the bills out of the box and collected the interest or even exchanged the bills. The bills had remained in the banker's hands at one period for a longer time than usual because of the illness of the customer. At the outset, the English court took judicial notice of the banker's lien. Nevertheless, it held that this lien was inapplicable in the case then before it. The Court (136 English Reports 212) stated that, "the right acquired by a general lien, is that of an implied pledge . . ." Following this, the opinion of the Court contains a most revealing statement:

> "Nor can it make any difference, that on the particular occasion out of which this action originated, on account of the illness of Burn, so long a time had elapsed from the obtaining of the securities without their being demanded by him for the purpose of being locked up in the tin box; for, if the defendants had not a right of lien upon them the moment they obtained them, the actual lien clearly could not afterward be claimed, when Burn's account had been overdrawn." (136 Eng. Rep. at p. 213.)

[10]Footnote 7 herein, and discussed at length in footnote 9, above.

The United States cases cited by the Code Commissioners commence with *Bank of Metropolis v. New England Bank* (1843), 1 How. (42 U. S.) 234, which represents a much litigated matter arising upon the following facts: The plaintiff (New England Bank) indorsed certain paper to the Commonwealth Bank for collection and the Commonwealth Bank sent the paper on for collection to the defendant Bank of Metropolis. The defendant Bank of Metropolis had a corresponding relationship with the Commonwealth Bank and they had mutual balances, sometimes in favor of one and sometimes in favor of the other. The New England Bank brought an action to recover the amount of the bills and notes in question after the Commonwealth Bank became insolvent. The Supreme Court, in reversing a judgment for plaintiff found that the notes appeared to be the *prima facie* property of the Commonwealth Bank, and held that without further notice to the contrary, the defendant Bank of Metropolis had the right so to treat them. The Court placed emphasis upon the extension of credit by the defendant bank and remanded the case to the Federal trial court where the case was tried before a jury. On the second appeal to the Supreme Court, Chief Justice Taney gave crystal clear treatment to our instant issue.[11] There the Supreme Court of the United States took the unusual step of setting forth sample instructions upon the further remand of the case. These instructions are of extreme importance, not only because of their application to the banker's lien generally, but they take on added significance since this case was also cited by the California Code Commissioners. We take the

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[11]*Bank of Metropolis v. New England Bank* (1848), 6 How. (47 U. S.) 212.

liberty of setting forth instruction number 2 in the language of the Supreme Court:

> "2. And if the Bank of the Metropolis had not notice that the Commonwealth Bank was merely an agent, but regarded and treated it as the owner of the paper transmitted, yet the Bank of the Metropolis is not entitled to retain against the real owners, unless credit was given to the Commonwealth Bank, or balances suffered to remain in its hands to be met by the negotiable paper transmitted or expected to be transmitted in the usual course of dealings between the two banks." (6 How. at p. 227.)

These two cases amply demonstrate the basis of the banker's lien. They clearly set forth the requirement that there must be an advance of credit upon the notes. In the instant case it is stipulated that no such credit was extended. The other two cases cited by the Code Commissioners support this contention.

In *Van Amee v. Bank of Troy* (1850), 8 Barb. 312, 5 How. Pr. 161, the plaintiff deposited a note for collection in the Canal Bank. The Canal Bank in turn transferred it to the defendant bank for collection and subsequently the Canal Bank failed before the maturity of the particular note but while it owed the defendant bank a balance. The defendant bank thereupon claimed the note under its right of lien and the plaintiff sued for the return of the note or its proceeds. It was held that the defendant bank had no right under the banker's lien. The New York Court, in reviewing the authorities, was faced with the holding of the *Brandao* case and the *Bank of Metropolis* case to the effect that the lien may exist if the depositor or forwarding bank holds out the note as its own. The Court nevertheless ruled that banks take so many notes for collection (with no passage of title) that

the collecting bank should have been on notice that the Canal Bank might not have owned the paper. The result of this reasoning led the Court to the conclusion that *the defendant bank could not, therefore, have relied upon these notes as security for advances or for a balance.*

The Court then went on to state:

> ". . . But what seems wholly inconsistent with any implied contract for a lien, on every Monday all balances were paid up. This note was in the hands of the defendants between three and four weeks before the Canal Bank failed; and consequently the two banks cleared all accounts two or three times during that. And had not the Canal Bank failed, they would have settled and paid all up on both sides, probably, many times before this note became due. This wholly repels the idea of any contract for a lien, express or implied." (8 Barb. at pp. 321-322.)

The last case cited by the Code Commissioners is *McBride v. Farmers' Bank of Salem* (1857), 25 Barb. 657. That case is similar in effect to the *Van Amee* case and also involved Canal Bank. The plaintiff had sent certain notes to the Canal Bank for collection and credit. The Canal Bank sent the notes to the defendant bank for collection and subsequently, the Canal Bank failed, owing the defendant bank money. The plaintiff sued to recover the note or the proceeds thereof. Defendant bank asserted a right of lien. The defendant bank contended that it believed that the Canal Bank owned the note. The New York Court expressly treated this allegation of the defendant bank as true. Nevertheless the Court refused to allow the defendant bank its right of lien. In so deciding, the Court made the following statement:

> ". . . But there is no pretense that the defendant ever parted with any thing, gave any credit, relin-

quished any security, or assumed any burthen or responsibility on the face of these notes. The evidence is that it did not." (25 Barb. 657, at p. 659.)

These, then, are the cases cited by those who recommended the adoption of the code section upon which appellee and the Courts below relied. They deal with many different types of situations; they deal with individuals as against banks and with banks against banks. They furnish, in themselves, a complete picture of the birth and growth of the concept of the banker's lien and they touch upon a myriad of situations in which that lien may or may not be applied. But in viewing the concept of the banker's lien as developed therein, one fact becomes inescapably clear. That is, there can be no lien unless there has been an extension of credit upon the faith of the notes upon which the lien is to attach. Cases dealing specifically with a banker's lien emphatically demonstrate that an indispensable requisite to the lien is such an advancement of credit or of money.

The dictum from the *Gonsalves* opinion relied upon by the Courts below in the instant case, therefore, cannot reasonably be interpreted as contradictory of the cases cited by the Code Commissioners or an overruling of California cases which have delineated the right of bankers, since 1872, under the Civil Code Section 3054. Although there is no California case precisely upon the facts stated in the instant case, there are cases to be cited in this brief which compel the conclusion that the bank's position (that is, the banker's lien applies if the customer owes the bank money and the bank has custody of any property of the customer's) is wholly unsound. Not only is that position unsound in view of the authorities, it is equally unsound when exposed to the light of reason. The banker's lien is in the nature of an im-

plied pledge, according to the *Brandao* case.[12] A lien must have some basis in equity and in policy. If a bank has not extended credit upon the faith of certain notes, how can it be said that the bank, in equity, is entitled to any lien upon those notes? The answer is, that the bank is not entitled to such a lien but on the contrary, such a purported lien would in truth be an outright preference.

2. The California Courts and Courts Generally Permit a Bank to Exercise a Lien Upon Commercial Paper Deposited With the Bank for Collection Only Where the Bank Has Extended Credit Upon the Faith of Such Paper.

As stated earlier in this brief, the banker's lien arose in order to protect a bank in situations where a depositor delivered considerable negotiable paper to the bank for discount or other forms of credit. The amounts involved often bore no relationship to the amounts actually collected on the paper, because the face amounts of such paper were not necessarily due and collectible at the time of the deposit. But if no credit were advanced upon the faith of the paper, no lien arose and there was no occasion to apply the rule of "implied pledge" discussed in the famous case of *Brandao v. Burnett*.[13]

The rule of the English cases is reflected in the law of this country, not only as stated in the cases cited by the Code Commissioners in the preceding section of this brief, but in many other cases as well. The Illinois Supreme Court, in an early leading case, stated, "Here, then, is the true principle upon which this, as well as other bankers' liens must be sustained, if at all. There must be a credit given upon the credit of the securities,

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[12]Footnote 7, above.

[13]See discussion in footnote 9, *supra*.

either in possession or in expectancy." (*Russell v. Hadduck* (1846), 8 Ill. 237, at p. 242.) The Illinois Court strongly reaffirmed this doctrine in *Niblack v. Park Nat. Bank* (1897), 169 Ill. 517. There X (bank) drew a check on the defendant bank, payable to the plaintiff. X bank had ample funds on deposit for the payment of the check, but the defendant bank also had a demand note of X bank's in excess of the amount of the check. The plaintiff presented the check for payment after the defendant bank had closed its doors. The question was whether the plaintiff could force payment by the defendant out of the X bank's deposits. The Court held that plaintiff could recover and that neither the rules concerning set-off or banker's lien could apply to the case, stating: " 'In the very nature of such transactions a banker's lien cannot extend to the money left on deposit with him, according to the customs and usages of banks. It has never been so extended, but is confined to securities and valuables which may be in the banker's custody as collaterals. The credit must be given on the credit of the securities or valuables, either in possession or expectancy. This is the extent of a banker's lien . . .' "[14]

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[14]169 Ill. at p. 521.

See, also, *National Bank v. Insurance Co.* (1881), 104 U. S. 54, at p. 71, and *Reynes v. Dumont* (1889), 130 U. S. 354, at p. 391, where the Supreme Court states that a banker's lien ordinarily "attaches in favor of the bank upon the securities and moneys of the customer deposited in the usual course of business, for advances which are supposed to be made upon their credit." An advance would be "supposed" to be made upon the credit of certain securities deposited with the bank where there had been some history of advancement of credit upon the faith of such notes. In the instant case it is stipulated that no credit was extended upon the faith of these securities and the history of the dealings between Salsbury and the appellee herein amply demonstrates that no credit in fact had ever been extended. On the contrary, the collections were made available to the debtor only after they had actually been placed in a deposit in the debtor's name.

The *Niblack* case was recently cited with approval by the Florida Supreme Court in *Everglades Cypress Co. v. Tunnicliffe* (1933), 107 Fla. 675, at p. 679. The bank in that case had claimed the right to certain deposits either under set-off or under lien. The Court held that set-off did not apply and that, of course, the banker's lien did not apply to deposits. In so holding, the Court stated:

> ". . . A lien arises from contracts or from operation of law. It does not by the customs and usages of banks extend to the moneys left on deposit with them. The banker's lien is confined to the securities and properties which have been placed in the bank's custody as collateral and its credit is extended on the strength of such collateral."[15]

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[15]The appellee herein, Bank of America, placed reliance in the Courts below upon *dicta* contained in *Kane v. First National Bank of El Paso* (C. C. A. 5th, 1932), 56 F. 2d 534. The *Kane* case was decided upon facts dissimilar to the instant case. The *dicta* in that case lend general support to the view of the appellee herein; nevertheless, the *Kane* case can be reconciled with the overwhelming authority on the subject of banker's lien in the light of its distinguishable facts: In the first place, the third party checks involved in the *Kane* case were *deposited in the account of the customer;* second, the checks were collected by the bank and the money seized on May 22, 1929 and the bankruptcy there involved did not commence until August 3, 1929; third, limited credit was extended by the bank on the deposit of these checks, as illustrated by the following statement in the Court's opinion (56 F. 2d at p. 535): ". . . Each check was on an out-of-town bank, and was received under a special agreement for collection, but entered as a credit on the bankrupt's account . . ."

Thus, although the bank did not allow credit to the full amount of these checks, some credit was allowed and, in fact, *an overdraft occurred but for the deposited checks.* (56 F. 2d at p. 535). Viewed in this light, the *holding* of the *Kane* case is consonant with established law, although the *dictum* contained therein is not. In Vol. 9 of Corpus Juris Secundum, at p. 520 we find the erroneous *dicta* of the *Kane* case used as authority for a statement appearing to favor the position of the Bank.

The California courts, to the knowledge of appellant, have never passed directly upon the question involved in the instant case. The California cases clearly indicate, however, that the rules theretofore discussed with respect to the limitations upon the banker's lien apply in California. In *Berry v. The Bank of Bakersfield* (1918), 177 Cal. 206, a depositor sued a bank to recover a stock certificate deposited with the bank as security for the payment of a note executed by the depositor to the bank. The depositor subsequently borrowed an additional amount from the bank, and still later tendered the balance due upon the first note and requested that the bank surrender the stock certificate. The bank refused to do so, contending that by virtue of the banker's lien, it had the right to retain the stock certificate as security for the payment of the second note. The Court found that there had been no agreement that the stock certificate should be held or pledged for the second note and that therefore it must be returned to the depositor, stating:

> "If, under the contract of the parties, the certificate was pledged as security, simply, for the fourteen thousand dollar note, the defendant was not entitled to hold it, under its alleged banker's lien, to secure another obligation. The banker's lien referred to in section 3054 of the Civil Code, was familiar, as a part of the law, long before the enactment of the codes. Section 3054 does not extend its scope. It has always been the rule that a banker holding se-

curities pledged for the payment of a particular debt has no lien upon them for the payment of other claims."[16]

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[16]177 Cal. at p. 209.

The Supreme Court of the United States had previously announced a similar rule in *Hanover National Bank v. Suddath* (1909), 215 U. S. 110, where a bank refused to extend credit upon negotiable paper placed by plaintiff with the bank for collection; subsequently, and while the bank held that paper, the bank allowed an overdraft in favor of plaintiff and upon discovering this fact wrote a letter to plaintiff stating that the credit had been extended upon the negotiable paper as collateral. The Supreme Court held that the plaintiff could recover the securities or the value thereof *and that the bank had no lien thereon.* The Court obviously deemed that notes in the custody of a bank for collection only are in such custody for a special purpose and not amenable to the banker's lien. This is illustrated by the Court's citation of *Biebinger v. Continental Bank* (1878), 99 U. S. 143, as authority for its denial of the lien. In the *Biebinger* case the plaintiff deposited with the defendant bank a note (of a third person) secured by a mortgage as security for the debt of plaintiff to the bank. Later, plaintiff withdrew the note and mortgage in order to collect the amount represented thereby, agreeing to replace them. As a replacement, plaintiff subsequently deposited with the bank a deed to the mortgaged property. Plaintiff finally paid off its indebtedness to the bank but did not regain possession of the deed; after this, plaintiff again became indebted to the bank and upon plaintiff's bankruptcy the bank claimed a lien upon the deed for the amount of the indebtedness. The Supreme Court held that the bank was not entitled to a lien.

See *Bank of Montreal v. White* (1880), 154 U. S. 660, also cited by the Court the *Suddath* case as authority for denial of the lien, where in a very short opinion the Supreme Court also held that a bank had no lien upon a note in the custody of the bank because the bank had refused to discount the note and consequently there was no evidence that the note was taken as security for past or future indebtedness.

In the instant case it is stipulated that the notes were taken for collection only and that no credit was advanced thereon.

Thus, the mere physical custody of the bank is not sufficient to warrant the indiscriminate application of its purported banker's lien.[17]

The California cases, by and large, are far more concerned with the right of set-off by the bank than they are with the banker's lien. There are no California cases

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[17]In *Della v. The Home Bank of Porterville* (1930), 105 Cal. App. 106, at p. 110, where the Court held that the bank could not exercise its lien upon a sum of money received by the bank for the sale of a certain chattel belonging to the depositor, because the sale of the chattel to the bank was in violation of Section 3440 of the California Civil Code. Thus, although the money belonged to the depositor, the Court insisted that the bank hold it in trust for the benefit of the creditors of the depositor and without benefit of the banker's lien.

The *Della* case again emphasizes the rule that where the bank has mere custody, instead of the legal possession required by C. C. C. 3054 and the cases describing the banker's lien, the bank has no right to convert the property of the customer to its own use under the alleged cover of such lien.

For a further example, see *Powell v. Bank of America* (1942), 53 Cal. App. 2d 458 (previously cited herein at footnote 4), where the defendant bank was held liable for the conversion of moneys, the bank obtained custody of the funds under instructions to deliver them to an individual against whom the bank held a judgment unenforcible because of the statute of limitations. The Court stressed the fact that the person to whom the funds were payable was not a customer of the bank and, at 53 Cal. App. 2d at page 463, discussed the bank's duty and position as an *agent*. The bank in the *Powell* case attempted to assert a lien but the Court refused to allow it.

Similarly, in *Anglo-Californian Bank v. Grangers' Bank* (1883), 63 Cal. 359, the depositor owned shares of stock in the depositary bank; the depositor sold his shares but the bank refused to allow a transfer to the purchaser until certain indebtedness of the depositor to the bank had been satisfied. The Supreme Court held that the lien under Section 3054 did not apply and reversed the trial Court, stating (63 Cal. at p. 364):

> ". . . The defendant was not in possession of the shares for which Fowler held the certificate, and such shares being his personal property, the defendant had no general lien upon it for any balance which might be due it from Fowler in the course of business. (Civ. Code Sec. 3054.) . . ."

indicating that the California rules governing the application of the lien are in any way different from those rules established under the law merchant. Indeed, as it has been shown herein by the citations from California cases, and from the discussion of the cases cited by the California Code Commissioners, it is clear beyond doubt that the California rule does not differ from the historic rule applicable to the banker's lien. Studied in this light, it is at once apparent that the dictum in the *Gonsalves* case, so strongly urged by appellee and by the courts below was merely an attempt to distinguish between set-off and the banker's lien.[18]

The general rule, then, is that securities placed in the custody of a bank for collection only are not subject to the so-called banker's lien unless the bank has extended credit in reliance upon the securities.[19] The Bank in the

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[18]See *American Surety Co. v. Bank of Italy* (1923), 63 Cal. App. 149, for a case in which the right of set-off was confused with the banker's lien as set forth in C. C. C. §3054.

[19]See, Wayne L. Townsend, *Bank Deposits of Commercial Paper*, 7 N. Y. Univ. Law Quar'ly Rev. 293, 618 at pp. 319-320:

> "The difference in the probative value of the fact of drawing when the question in dispute is ownership of the deposited item and when the controversy involves a lien upon an admitted collection item is apparent. In the former case, the matter of ownership is almost universally settled without reference to the amount which depositor has drawn; if a debtor and creditor relation is found to have been established, the bank is complete owner of the instrument, handles it as its own property and is entitled to the whole of the proceeds. In the latter case, the extent of the bank's interest depends entirely upon a showing of the amounts which have been drawn on the strength of the item; it stands in the position of a pledgee with collateral in his hands; it has the 'special property' of a pledgee in, or a banker's lien upon, the item, while the 'beneficial ownership' remains with the depositor."

instant case was a mere custodian and acquired no possession, in the legal sense, such as would entitle it to exert a lien upon the notes and drafts belonging to Salsbury.[20]

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[20]The appellee Bank's position herein, that it is entitled to the lien upon the mere facts of custody and indebtedness, collapses in the light of the many cases cited herein where such facts existed but no lien was allowed. But before closing this section of his brief, appellant respectfully invites the attention of this Honorable Court to other cases denying to banks the right of lien where the banks had bare custody only:

In re Cummins Construction Corporation (1947, D. C. Md.), 72 Fed. Supp. 409. There, the bankrupt owed money to two banks on certain notes. One of the banks had previously lent money on a certain government contract and had taken an assignment of the government payments. Later, the government loan was paid off but the assignment had not been cancelled. After the loan had been paid off, the government continued to send the checks to the bank and the bank applied those checks on the other indebtedness of the customer, having already set-off money on deposit. Adjudication of bankruptcy followed these actions of the bank and the trustee entered into a compromise with the bank whereby the trustee was to receive the part of the government check appropriated by the bank. This compromise was before the District Court on the request of the creditors. Compromise held valid. The Court stated that the creditors and the trustee are in agreement that the amount appropriated by the bank from the government check must be returned on the ground that it was a voidable preference. The bank had asserted a banker's lien upon the check, but the Court held that the banker's lien could not apply. Affirmed on appeal, *Hughes & Co. v. Machen* (1947, C. C. A. 4), 164 F. 2d 983. The Court on appeal merely assumed as obvious the fact that the bank had no right to the government check under a lien theory. It is clear from the case, that the advances of the bank based upon these government checks had been paid off by the debtor (bank's customer).

Moore v. Third National Bank (1910), 41 Pa. Sup. Ct. 497. There the bank accepted a check for collection only but bankruptcy intervened prior to collection. The Court stated (41 Pa. Sup. Ct. at pp. 502-503):

> "... The deposit of these checks was not a deposit of money; the bank took the checks for collection only; it advanced no money upon them and parted with nothing upon the faith of the deposit; it was not the holder of the checks for value ..."

3. **The Purported Application of the Banker's Lien Herein Is Contrary to the Spirit and Purposes of the Bankruptcy Act and Particularly Offensive to a Proceeding Under Chapter XI Thereof.**

Assuming the application of the banker's lien by the courts below is not compelled by California Civil Code, Section 3054, there is still another ground for reversal. The seizure by the Bank of Salsbury's commercial paper in its hands for collection only could have no effect except to thwart the desirable end sought in a Chapter XI proceeding. This is particularly true where, as here, the same creditor had already seized the cash in Salsbury's bank account and claimed the right to Salsbury's real property as security for the debt.

The following general and well accepted distinctions between an average bankruptcy proceeding and a proceeding under Chapter XI have been set forth in 8 Collier on Bankruptcy (14th Ed.), at p. 20:

> "In the ordinary bankruptcy proceedings under Chapters I to VII of the Act, the estate is administered for the purposes of liquidation and distribution. The trustee is required to collect and reduce to money the property of the estate, and in §65 provision is made for dividends to general creditors. Thus, §65a states that capital 'dividends of an equal percentum shall be declared and paid on all allowed claims, except such as have priority or are secured.' A liquidation and distribution of the debtor's property is not contemplated during the administration of a proceeding under Chapter XI. That chapter provides for the

proposal of an arrangement for the settlement, satisfaction, or extension of time of payment of unsecured debts."

The Court of Appeals for the Third Circuit recently applied this reasoning to a reorganization under Chapter X and held that the rules of set-off contained in Section 68 of the Bankruptcy Act are not to be applied in every case, and that ". . . the reorganization court is not bound to apply, willy-nilly, the set-off rule of Section 68 of the Bankruptcy Act."[21] In view of the Bank's retention of its real property security herein, upon which the loans were actually made to Salsbury, and in view of the Bank's set-off of Salsbury's bank deposits, it would appear to be entirely out of keeping with the spirit of the Bankruptcy Act and a great injustice to the other creditors of the debtor to allow either the doctrine of set-off or of banker's lien to apply in the instant case as affecting the negotiable paper in the custody of the bank only for collection at the time of the filing of the petition herein.

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[21] *Susquehanna Chemical Corp. v. Producers Bank & Trust Co.* (April 27, 1949), C. C. H. Bankruptcy Law Service, par. 56, 415, p. 59,668 at p. 59,671. The Court cites, as authority, in footnote 7 on p. 59,671, *Lowden v. Northwestern Nat. Bank* (1936), 298 U. S. 160; same case on remand, 74 F. 2d 847 (C. C. A. 8th, 1936), cert. den. 299 U. S. 583 (1936); *In re American Coils Co.,* 74 Fed. Supp. 723 (D. C. N. J., 1947.)

The Court also cited text authority: Finletter, *The Law of Bankruptcy Reorganization,* 303 *et seq* (1939); 11 *Remington, Bankruptcy,* §4528 (1947). 6 Collier, *Bankruptcy,* par. 9.09 (14th Ed. 1940), p. 2819.

It is certainly clear that the Supreme Court of the United States, in declaring the federal law on this subject as shown by the cases cited herein,[22] does not allow any lien unless credit has actually been extended upon the face of the negotiable instruments in the hands of the alleged lienor. To allow the bank a right of lien on this paper, without any extension of credit thereon, would constitute a clear preference and thereby controvert a basic principle of the Bankruptcy Act. In an ordinary bankruptcy proceeding, the Supreme Court of the United States stated that

> ". . . nothing decided in *Erie R. Co. v. Tompkins, supra,* requires a court of bankruptcy, in applying the statutes of the United States governing the liquidation of bankrupts' estates, to adopt local rules of law in determining what claims are provable, or to be allowed, or how the bankrupt's estate is to be distributed among claimants. [Citing cases.] In passing upon and rejecting or allowing the proof of claim in this case, the court of bankruptcy proceeds—not without appropriate regard for the rights acquired under state law—under federal statutes which govern the proof and allowance of claims based on judgments. In determining what judgments are provable and what objections may be made to their proof, and in determining the extent to which the inequitable conduct of a claimant in acquiring or asserting his claim in bankruptcy, requires its rejection or its subordination to other claims which, in other respects are of

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[22]*Bank of Metropolis v. New England Bank* (1843), 42 U. S. 217; *ibid.* (1848), 47 U. S. (6 How.) 212; *Biebinger v. Continental Bank* (1878), 99 U. S. 143; *Bank of Montreal v. White* (1880), 154 U. S. 660; *National Bank v. Insurance Co.* (1881), 104 U. S. 54; *Reynes v. Dumont* (1889), 130 U. S. 354; *Hanover National Bank v. Suddath* (1909), 215 U. S. 110.

the same class, the bankruptcy court is defining and applying federal, not state, law."[23]

The bankruptcy court is entitled to "ascertain the validity of liens, marshal them, and control their enforcement and liquidation."[24]

It is submitted that there is every reason both in policy and authority, to deny the enforcement of a lien upon commercial paper when there has been no extension of credit

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[23]*Heiser v. Woodruff* (1946) 327 U. S. 726 at p. 732. See also, the more recent case of *Vanston Bondholders Protective Committee v. Green* (1946), 329 U. S. 156 at pp. 162-163:

". . . But bankruptcy courts must administer and enforce the Bankruptcy Act as interpreted by this Court in accordance with authority granted by Congress to determine how and what claims shall be allowed under equitable principles. And we think an allowance of interest on interest under the circumstances shown by this case would not be in accord with the equitable principles governing bankruptcy distribution." The *Vanston* case was a Chapter X proceeding.

See also *Susequehanna Chemical Corp. v. Producers Bank and Trust Co., supra,* footnote 21:

"2. The interpretation and application of Chapter X are matters of federal law, just as the criteria for distribution to creditors in bankruptcy are controlled by federal law. See *Prudence Realization Corp. v. Geist,* 316 U. S. 89, 95 (1942); *Vanston Bondholders Protective Committee v. Green,* 329 U. S. 156, 162 (1946); *Petition of Portland Electric Power Co.,* 162 F. 2d 618, 621 (C. C. A. 9, 1947). A right which would have been granted under state law may be disregarded in order to effect an equitable distribution of assets within the policy of the Bankruptcy Act. *Vanston Bondholders Protective Committee v. Green, supra.* The argument is a fortiori in a reorganization proceeding where the jurisdiction of the court is broader than in bankruptcy and the continuance of the business rather than liquidation is in prospect. Specifically on the subject of set-off, see Finletter, *The Law of Bankruptcy Reorganization,* 303 *et seq.* (1939); 2 Gerdes, *Corporate Reorganizations,* §759 (1936); 6 Collier, *Bankruptcy,* par. 9.09 (14th Ed. 1940); 11 Remington, *Bankruptcy,* §4528 (1947)." (C. C. H. Bankruptcy Law Serv., p. 59,668, par. 56,415, at p. 59,669.)

[24]*Pepper v. Litton* (1939), 308 U. S. 295, at p. 306; see also *Isaacs v. Hobbs Tie and Timber Co.,* 282 U. S. 734.

upon the faith of that paper. Liens, being in the nature of implied pledges, are traditionally deemed to be based upon a detriment suffered with respect to the burdened property. The facts of this case show no such detriment and reliance. If the right of set-off may be denied in proceedings under Chapters X and XI, an even stronger case presents itself for the denial of the so-called banker's lien. The right of set-off is an ancient equitable doctrine, clearly applicable to bank deposits. On the other hand, if the Bank should be found correct in its assertion that the banker's lien is applicable to the present case, then that doctrine is exposed as a fictitious appendix, divorced from the common-sense that originated it and swollen beyond all recognition. It would be the glorification of an erroneous rule of law completely out of keeping with the rest of the Bankruptcy Act; a preference would be granted to banks upon no basis except that the lien upon securities once accorded banks to protect advances made upon the faith of such securities has now become a lien upon securities irrespective of advances.

The Courts below, in the instant case, considered themselves bound by the erroneous interpretation of the dictum in the *Gonsalves* case. Appellant submits that the California Supreme Court never purported, by that dictum, to delineate all the rules surrounding the exercise of the banker's lien. The erroneous rule asserted by the Bank of America, has no place in the administration of bankrupt estates. Banks are already in a peculiarly favored creditor position because of the right of set-off. Banks are also reluctant to lend money without express and contracted security. The addition of the alleged banker's lien to these remedies would effect an unwarranted preference and would, in this Chapter XI proceedings, defeat the purposes of the Bankruptcy Act.

CONCLUSION.

In this brief, the appellant has attempted to present an exhaustive survey of the problems involved in the instant appeal both from the standpoint of the law as it is interpreted by the courts today and the law as it stood at the time of the enactment of California Civil Code, Section 3054. Emphasis has been placed upon the law merchant for the reason, which we think should be beyond contradiction, that the enactment of Section 3054 was intended to be no more than a codification of the old rules under the commercial law. It is also significant to the consideration of this problem that banking institutions today are far removed from their counterparts in the 17th and 18th centuries in the scope of their activities. The banker for whose benefit the banker's lien was devised apparently engaged principally in safeguarding funds and money for some special purpose (often contemplating the ultimate return of such items to the customer) and in giving immediate credit on commercial bills by a simple method such as by discounting. The collection of such bills was a connected service, performed by the banker both for the benefit of himself and for his customer.

Today a banking institution covers the activities of all of us. In this respect it may be likened to the present day drug store. For all practical purposes, it buys and sells everything. Banks engage in every form of credit transaction; they deal in trust receipts, warehouse receipts, conditional sales, chattel mortgages, and a myriad of other commercial and security transactions. Banks also do considerable business as trustees and as escrow holders. More than this, banks deal with numerous correspondent banks, sometimes branches of their own institutions, and these connections are used for complicated, long range

collections with resulting credits and balances among the various banks. These commercial facts are known to everyone and we feel are judicially known by this Honorable Court.

Without any hint of disrespect to banks generally and the Bank of America in particular, it is well known that every effort is made by these institutions to insulate themselves with appropriate legislation. Thus, in the collection of commercial paper, *even where credit is extended thereon to the customer,* the bank seeks to act only as the agent for the customer and for all practical purposes without responsibility, for the activities or solvency of its correspondent banks; and further, without responsibility for the ultimate payment by the drawee of the note. Accordingly, the credit allowed on commercial paper is provisional only and conditioned upon the ultimate payment, and receipt by the bank allowing such credit, of the funds represented by the instrument. If the collecting banks fail, or the note is dishonored, the credit may be charged back to the customer. This result, so desirable from the point of view of the bank, has been accomplished by Section 16c of the California Bank Act. (Stats. 1925, p. 513, as amended; 1 Deering's General Laws, p. 212.) In the present case, however, the Bank does not cherish the pinch of agency. Rather, it desires an interest in the negotiable paper; it embraces the notes and drafts belonging to Salsbury as though they were collateral, and the Bank an implied pledgee. All this it seeks to accomplish with the so-called banker's lien. In other words, if the orders below are affirmed, the Bank may be either an agent or an alleged creditor holding security, depending upon which is more convenient to the Bank and which legal theory happens to be more helpful at that par-

ticular moment. We feel that this "inconsistency by convenience" should be eliminated by this Court in this case.

It is customary today for the average businessman to collect his commercial paper through a bank. When the bank extends credit in return for the paper, it then assumes the banking function as that function was understood at the time of the birth of the banker's lien. But where the bank merely accepts that paper as a custodial and collection agent, giving nothing in return therefor, it is acting mort as an escrow holder or a depository for a special purpose than as a bank. In the performance of this latter function, the banks do not have and never had a right of lien. Under Section 16c of the Bank Act, the Bank herein would have been a mere conduit even if it had extended credit on the notes. How can it claim more in the present case?

The stand taken by the Bank of America calls to mind the language of the Court in *Bayle v. First Natl. Bank of Glen Falls* (1937) 6 N. Y. S. 2d 484, where a bank acting as a transfer agent of shares of stock, sought to retain those shares on the ground that they were deposited by a debtor of the bank. In its opinion, the Court stated (at p. 489):

> "Such physical possession of them as the defendant ever secured, and the possession it now has was a legal possession only as its own transfer agent . . . the defendant was obliged to proceed as its own transfer agent and as the agent of the plaintiff to complete the matter as it had been directed to do. Then there arose a duty for the defendant to act without letting its left hand know what its right hand was doing."

For the reasons hereinabove stated, appellant respectfully urges that this Honorable Court reverse the orders of the Courts below; that the objections of the receiver to the claims of the Bank of America be sustained and that the Bank be ordered to pay forthwith to the estate the sum of $178,950.93.

Respectfully submitted,

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By MARTIN GENDEL,

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